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DEPT FOR NEA/FO, NEA/IPA, EB/IFD, TREASURY FOR HIRSON, NSC
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SUBJECT: FISCHER SAYS ISRAELI ECONOMY BOOMING AS FINANCE
MINISTRY CHANGES HANDS

REF: TEL AVIV 975

Classified By: Ambassador Richard H. Jones for reasons 1.4 b and d.

Summary

¶1. (C) In an April 25 meeting Stanley Fischer, the Governor of the Bank of Israel (BOI), had no comment for the Ambassador on Finance Minister Hirschson's suspension/resignation, but commented that Olmert has been a good Finance Minister in the past. He said that the economy is in excellent shape, with interest rates low, the shekel strong, and the budget underspent. He praised the Trajtenberg Economic Plan as addressing important issues -- especially education reform -- while still maintaining fiscal restraint. He stressed the benefits of Israeli OECD membership for promoting reform, was positive about an enhanced Free Trade Agreement with the U.S., and said that the JEDG (Joint Economic Development Group) had contributed significantly to Israel's economy. Finally, Fischer was discouraged over the BOI wage dispute, indicating that he saw no end in sight. End Summary.

Olmert a Good Finance Minister

¶2. (C) On being asked by the Ambassador his reaction to the Hirschson suspension/resignation, Fischer demurred, saying only that Prime Minister Olmert, who has taken over the portfolio for the time being, was a good Finance Minister in the past. He called Olmert a "quick study and a good decision maker," and praised his early meeting with MOF DG Yarom Ariav. (Comment: Hirschson's decision to take leave of his office on April 22 came after months of investigations into possible financial improprieties. He was not considered to be a dynamic force, and the Tel Aviv stock market rose about one percent after his departure was announced. However, he did have several important achievements to his credit, including quick passage of the 2006 and 2007 budgets, and the recent passage of his economic program -- including the negative income tax. Most importantly, he resisted the pressure to increase spending, maintaining a policy of fiscal restraint. At this point, it is unclear who will ultimately receive the portfolio. Olmert may not be allowed to hold it for long because he is also being investigated for alleged wrongdoing with regard to the decision making on the Bank Leumi privatization when he was Finance Minister in the Sharon government. End comment.)

Strong Shekel Due to Worldwide Weakness of Dollar

13. (C) Fischer said that the strong shekel is in part due to the worldwide weakening of the dollar -- an inevitable adjustment to the size of the U.S. current account deficit. With the lowering of the Israeli interest rate to 3.75 percent on April 22, the Israeli rate is now 1.5 percentage points below the U.S. rate. However, the Israeli ten year rate is five percent, as opposed to about 4.65 percent in the U.S., still stimulating capital inflows to Israel. As Israeli long rates decline, speculative inflows will decline.

Another factor contributing to the shekel's strength is Israel's strong balance of payments. Fischer noted that Israel has an inflation target (two percent), which can be reached by printing currency while keeping the shekel/dollar rate constant. This would result in a decline in the competitiveness of Israeli products. Such a decline may be inevitable. If so, allowing the shekel to appreciate would be the preferred method. Israel exports more to Europe than to the U.S. About 40 percent of its exports are to the U.S., but 70 percent of the goods it purchases are priced in dollars. In deciding which type of basket to use to measure inflation, Fischer said he was moving towards one more representative of the currencies of the countries with which Israel does business, rather than the present one which is determined by the currency in which the prices of major commodities are quoted.

Budget Will be Underspent

14. (C) Fischer said that the economy is strong and tax

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receipts are up. The government will "overachieve" on the budget, although the MOF is being very secretive regarding the amount the budget is being underspent. He maintained that worldwide growth will "probably continue," an important factor for the Israeli economy, which is very dependent on the international business cycle and the security situation. Israel's hi-tech exports make it particularly dependent on the U.S. economy, which is "looking better on the whole."

Praise for Trajtenberg Plan

15. (C) Fischer praised the Trajtenberg economic plan, (Note: named for Manuel Trajtenberg, the head of the National Economic Council, See Reftel. End note) passed by the Cabinet on April 22. He said it includes all of the elements of the previously passed Hirschson plan, such as the negative income tax, in addition to some new ones, such as a greater emphasis on day care so that mothers can more easily join the work force. Among the most important of the plan's goals is a greater labor participation rate for Ultra-Orthodox Jews (Haredim), particularly males, which Fischer claimed will remain difficult without a cultural shift in that community. Despite the plan's seeming call for increased spending, Fischer said that Trajtenberg recognizes the continuing need for fiscal restraint. Fischer volunteered that Trajtenberg made a mistake, however, in stating publicly that the time has come to focus more on reducing poverty and increasing employment and less on continuing basic economic reform.

Education Reform Essential

16. (C) Fischer also stressed the importance of improving Israel's educational system over the long-term, which the Trajtenberg Plan also addresses. He called the existing system "quite inefficient," noting that Israel spends relatively more per student than OECD countries. One reason

for the poor performance is that Israel's educational system has several parts -- regular public schools, and separate Haredi and Arab systems, as well as many private schools. The regulations for each system differ, as do the performance standards. In the past, the education bureaucracy always demanded more funding. Now, however, the Education Minister (Labor's Yuli Tamir) accepts the need for reforms, and not just more money.

OECD Membership Important

¶7. (C) On Israel's effort to join the OECD, Fischer maintained that the OECD was interesting in broadening membership. Beginning the accession process would be healthy for Israel as working groups would need to be established in each government ministry to meet with their OECD counterparts. Dealing in this way with the bureaucracies of other member countries would make the Israeli bureaucracy more sophisticated and also help it escape the isolation it experiences in the region. He hopes for a positive outcome for Israel on the issue at the May OECD Ministerial. (Note: We understand Fischer has been actively and successfully lobbying OECD member states on its accession request, including Japan and EU countries. End Note)

Enhanced FTA, JEDG

¶8. (C) Fischer responded positively when the Ambassador, noting that Israel was increasing its service exports, mentioned the need to upgrade the U.S.-Israel Free Trade Agreement. On the JEDG (Joint Economic Development Group), Fischer commented that it had had a tremendous positive impact on the Israeli economy. The last meeting included a discussion of the need for land reform, which he said was a very difficult undertaking due to the entrenched views of the bureaucracy on the issue. However, he was cautiously hopeful that progress might even be registered in this area.

Fischer Dejected Over BOI Wage Dispute

¶9. (C) When the Ambassador raised the issue of the labor

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dispute at the BOI, Fischer responded dejectedly that the situation has moved "beyond the rational; whenever a solution is in sight, the MOF raises new problems." The latest is that while Fischer had agreed to differentiate between the salary scales for existing and new employees, the MOF claimed that he had agreed that salaries of new professionals would be ten percent lower than that of veterans. Fischer said he had never agreed to that, since it would make it impossible for the BOI to compete for entry-level talent with the private financial sector. Fischer said he had only agreed that clerical workers would be paid according to the (lower) government pay scale.

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JONES